The brief introduction of EJV & CJV

EJV (Equity Joint Ventures)

Equity joint ventures are the second most common manner in which foreign companies enter the China market and the preferred manner for cooperation where the Chinese government and Chinese businesses are concerned. Joint ventures are usually established to exploit the market knowledge, preferential market treatment, and manufacturing capability of the Chinese side along with the technology, manufacturing know-how, and marketing experience of the foreign partner.

Normally operation of a joint venture is limited to a fixed period of time from thirty to fifty years. In some cases an unlimited period of operation can be approved, especially when the transfer of advanced technology is involved. Profit and risk sharing in a joint venture are proportionate to the equity of each partner in the joint venture, except in cases of a breach of the joint venture contract.

Share holdings in a joint venture are usually non-negotiable and cannot be transferred without approval from the Chinese government. Investors are restricted from withdrawing registered capital during the live of the joint venture contract. Regulations surrounding the transfer of shares with only the approval of the board of directors and without approval from government authorities will probably evolve over time as the size and number of international joint ventures grow.

There are specific requirements for the management structure of a joint venture but either party can hold the position as chairman of the board of directors. A minimum of 25% of the capital must be contributed by the foreign partner(s). There is no minimum investment for the Chinese partner(s).

It is preferable that foreign exchange accounts are balanced in order to remit profits abroad so that the repatriated foreign exchange is offset by exports from the joint venture. With the elimination of foreign exchange certificates and the further opening of the China market, this requirement is becoming more and more relaxed.

The permissible debt to equity ratio of a joint venture is regulated depending on the size of the joint venture. In situations where the sum of debt and equity is less than US$ 3 million, equity must constitute 70% of the total investment. In joint ventures where the sum of the debt and equity is more than US$ 3 million but less than US$ 10 million, equity must constitute at least half of the total investment. In cases where the sum of the debt and equity is more than US$ 10 million but less than US$ 30 million, 40% of the total investment must be in the form of equity. When the total investment exceeds US$ 30 million, at least a third of the sum of the debt and equity must be equity.

Equity can include cash, buildings, equipment, materials, intellectual property rights, and land-use rights but cannot include labor. The value of any equipment, materials, intellectual property rights, or land-use rights must be approved by government authorities before the joint venture can be approved.

After a joint venture is registered, the entity is considered a Chinese legal entity and must abide by all Chinese laws. As a Chinese legal entity, a joint venture is free to hire Chinese nationals without the interference from government employment industries as long as they abide by Chinese labor law. Joint ventures are also able to purchase land and build their own buildings, privileges prevented to representative offices.

CJV (Contractual Joint Venture)

In a Sino-Foreign Contractual Venture (also known as Cooperative Joint Venture), the parties involved may operate as separate legal entities and bear liabilities independently rather than as a single entity. A cooperative venture may also be registered as a limited liability entity resembling an equity joint venture in operation, structure, and status as a Chinese legal entity.

There is no minimum foreign contribution required to initiate a cooperative venture, allowing a foreign company to take part in an enterprise where they preferred to remain a minor shareholder. The contributions made by the investors are not required to be expressed in a monetary value and can include excluded in the equity joint venture process can be contributed such as labor, resources, and services. Profits in a cooperative venture are divided according to the terms of the cooperative venture contract rather than by investment share, allowing a more flexible schedule for return on investment in cases where one investor provides cash while the other party's investment is primarily in kind.

Greater flexibility in the structuring of a cooperative venture is also permissible including the structure of the organisation, management, and assets. There is no term for unlimited terms in cooperative ventures, but also no provisions for the term of the duration. The term of the cooperative venture contract may be renewed subject to the consent of the parties involved and approval from the examination and approval authorities. The foreign investor is permitted to withdraw their registered capital or a portion thereof from the cooperative venture during the duration of the cooperative venture contract.

Because of the unique privileges and added features offered to the foreign party in a cooperative venture, trade unions must be allowed to represent the employees in employment matters to protect the interests of the employees.

The Comparison between EJV & CJV

The principal differences between an EJV and a CJV can be simply summarised as follows:

- For an EJV:

1. Each party must make cash or permitted in cash contributions in proportion to its subscribed percentage of the EJV's registered capital.

2. Profit must be distributed strictly in accordance with the parties' respective percentage shareholding of the registered capital of the EJV.

3. Upon dissolution of the EJV at the expiry of the term of operation, the EJV's net assets are to be distributed to each party in accordance with its respective shareholding of the EJV's registered capital.

- For a CJV:

1. A party (typically, but not always, the Chinese party) may contribute non-cash intangibles in the form of "cooperative conditions". Such "cooperative conditions" may consist of market access rights, rights to use buildings or office space owned or leased by the party that are not subject to clear valuation. In exchange for such "cooperative conditions", the party is entitled to participate in the distributable earnings of the CJV.

2. Profit sharing in a CJV need not be made strictly in accordance with the parties' respective percentage shareholding of the registered capital of the CJV but can be made in accordance with the agreement of the parties (e.g. the Chinese party may be entitled to a fixed profit share with the balance to be distributed to the foreign party, or the parties may agree on a multi-tiered profit-sharing arrangement that permits the foreign party to recover an amount equal to its capital investment on a priority basis, following which the profit split will be changed, etc.).

3. Upon dissolution of the CJV at the expiry of the term of operation, the CJV's net assets may be transferred to the Chinese party without compensation (thus operating in many respects as a BOT project) so long as the foreign party has been able to recoup its capital contribution during the term of the CJV. Such recoupment typically is funded by excess cash flow generated by accelerated depreciation of the CJV's assets. Such arrangement requires approval of relevant finance and tax authorities in China. Note that this capital recoupment is separate and distinct from possible priority rights to receive after-tax net profit distributions as outlined in the bullet point above.